

CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

Minutes

January 22, 2009

The Capital Projects and Bond Oversight Committee met on Thursday, January 22, 2009, at 1:00 p.m. in Room 169 of the Capitol Annex. Representative Mike Denham, Chair, called the meeting to order.

Present were:

Members: Mike Denham, Co-Chair; Senators Julian Carroll, Bob Leeper, and Elizabeth Tori; and Representatives Steven Rudy and Jim Wayne.

Guests testifying before the meeting: John Hicks, Governor's Office for Policy and Management; Kathy Frye and Mark Cornett, Cabinet for Health and Family Services; Steve Mason and Ed Fields, Kentucky State University; Bob Wiseman, University of Kentucky; Scott Aubrey, Charles Bush, and Jerry Graves, Finance and Administration Cabinet; Sandy Williams, Kentucky Infrastructure Authority; Glen Caldwell, Mayor of Williamstown; Clay Crupper, Mayor of Dry Ridge; Allen Robinson, CDP Engineers; Katie Smith, Cabinet for Economic Development; and Tom Howard and Brett Antle, Office of Financial Management.

LRC Staff: Shawn Bowen, Don Mullis, Kristi Culpepper, Samantha Gange, and Jennifer Luttrell.

Representative Denham called on Shawn Bowen, Legislative Analyst, to discuss several items of business. Ms. Bowen asked the Secretary to take the roll and indicated that the Committee had a quorum. Ms. Bowen welcomed two new members to the Committee, Senator Julian Carroll and Senator Bob Leeper.

Representative Wayne made a motion to approve the minutes of the December 16, 2008, meeting. The motion was seconded by Representative Rudy and approved by voice vote.

Next, Ms. Bowen said that an election for a new Senate Co-Chair was needed. [Senator Elizabeth Tori, the previous Senate Co-Chair, will remain a member of the Committee, but will no longer be Co-Chair.] Senator Tori nominated Senator Leeper for the position of Senate Co-Chair. The motion was seconded by Senator Carroll. Senator Carroll then made a motion that nominations cease and that Senator Leeper be elected

Senate Co-Chair by acclamation. The motion was seconded by Senator Tori and approved by voice vote.

Ms. Bowen said members' folders contained three items of correspondence: quarterly construction reports from the Finance and Administration Cabinet, and the universities that manage their own construction projects; the quarterly report from the Administrative Office of the Courts; and correspondence from the Finance and Administration Cabinet reporting the use of the Construction Management-at-Risk (CM-at-Risk) project delivery method for the Eastern State Hospital Replacement project.

Also included in the members' folders were two information items: a spreadsheet submitted by KIA containing Fund A and Fund F loans approved prior to the projects being bid, and the monthly staff update.

Ms. Bowen then reported that the Kentucky Infrastructure Authority staff has requested a correction be made to the March 20, 2008 minutes. The minutes reflect an incorrect loan amount of \$548,000 for a Fund B Loan for Whitley County. The actual loan amount as reported to the Committee was \$848,000.

Senator Leeper made a motion to approve the amended minutes of the March 20, 2008 meeting. The motion was seconded by Senator Tori and approved by voice vote.

Representative Denham congratulated Senator Leeper as the newly elected Co-Chair and also welcomed Senator Carroll to the Committee.

Representative Denham asked John Hicks, Acting Budget Director, Governor's Office of Policy and Management, to discuss the Finance Cabinet's monthly report. Mr. Hicks reported that the Finance Cabinet has approved an \$85,600 (17%) federally funded scope increase for the Transportation Cabinet Purchase Bridge Snooper project. This project was authorized in the 2008-10 budget at a scope of \$500,000 (Road Funds). The funds will allow the Transportation Cabinet to purchase a custom-made specialized piece of bridge inspection equipment known as a "snooper."

Representative Rudy made a motion to approve the scope increase for the Transportation Cabinet Bridge Snooper project. The motion was seconded by Senator Carroll and passed unanimously by roll call vote. The revised project scope is \$585,600.

Mr. Hicks then reported a \$96,500 federally funded scope increase for an information technology project for the Cabinet for Health and Family Services. The project, entitled Kentucky Automated Management and Eligibility System (KAMES), was initially authorized in the 2004-06 budget at a scope of \$18,667,000. In July 2007, the Committee approved a 100% federally funded scope increase in the amount of \$2,183,000.

The intent of the project is to upgrade an aging mainframe based computer system that supports state supplementation programs such as TANF, food stamps, and Medicaid Eligibility. The new system will enable the Cabinet to have an electronic case file and keep track of the thousands of Kentuckians who receive services. This request for a scope increase will allow further upgrades to the system.

Senator Carroll asked when the system will be fully implemented. Mr. Hicks said that the system should be running by November 2010.

Senator Carroll asked if this new system would result in any savings or increased efficiency. Mr. Hicks deferred to Kathy Frye, Deputy Executive Director, Office of Administrative and Technology Services, and Mark Cornett, Deputy Commissioner with the Department for Community Based Services. Ms. Frye said that the new system will provide for an electronic case file which will help the caseworkers work more efficiently by eliminating paper files. The information will be more readily available for both the caseworker and the client. Mr. Cornett added that the new system would cut down on clerical work such as copying and mailing.

Senator Carroll asked Mr. Cornett to discuss the personnel reduction the Cabinet has had in the past few years. Mr. Cornett responded that he would have to submit the information formally to the Committee.

Senator Tori asked if the new automated system would help expedite the agency's caseload. Mr. Cornett said that it would.

Senator Carroll made a motion to approve the scope increase. The motion was seconded by Representative Rudy and passed unanimously by roll call vote. The revised project scope is \$20,946,500.

Mr. Hicks next reported that the Finance and Administration Cabinet has approved an unbudgeted project for Kentucky State University (KSU) to purchase an Administrative Computing System. The total cost for the system is \$4 million, and will be funded with a combination of federal funds (\$2,400,000) and agency restricted funds (\$1,600,000). The new computer system will replace the current Student Information System and the Human Resource System, which has become obsolete.

Senator Carroll inquired as to the age of the university's current computer system. Steve Mason, Special Assistant to the President, KSU, and Ed Fields, Director of Information Technology, KSU, came forward to discuss the project. Mr. Fields said the current system, which dates back to 1984, has been periodically upgraded. However, the system is to the point now that it no longer meets the university's needs. Mr. Fields said the new computer system will be implemented over an 18 to 24 month period.

In response to questions from Representative Wayne, Mr. Mason said the restricted fund source for this project is technology fees paid by students. He added that these technology fees were previously used for information technology operating expenses. Mr. Mason said there would not be any increases in student fees to fund this project.

Representative Rudy asked how long the new system is projected to last. Mr. Mason responded that he did not know for sure how long it would last. Mr. Fields said the vendor is committed to higher education and upgrading and modernizing the system to keep up with current times.

Senator Tori asked what KSU will do for support until the new system is implemented. She noted that the new system would not be up and running until May 2010, and according to information included in members' folders, the current vendor no longer provided support as of December 31, 2008. Mr. Mason responded that vendor support for the current system does not end until 2011. Mr. Fields agreed with Mr. Mason, stating the vendor support for the system expires in 2011. [The information in question refers to correspondence submitted by the university to the Finance Cabinet noting computer support expires December 31, 2008.]

Senator Carroll made a motion to approve the KSU project. The motion was seconded by Representative Wayne and passed unanimously by roll call vote.

Next, Senator Tori recognized Bob Wiseman, Vice President for Facilities Management, University of Kentucky (UK). Mr. Wiseman asked the Committee for its approval of an unbudgeted project to renovate Wildcat Lodge. The project scope is \$1.5 million and will be funded by private funds. The renovations will include general refurbishment of the interior finishes, interior lighting improvements, and replacement of nonfunctioning exterior glass doors.

Representative Wayne asked if prevailing wage laws would apply to this project. Mr. Wiseman responded that they would.

Senator Carroll made a motion to approve the Wildcat Lodge Renovation project. The motion was seconded by Representative Wayne and passed unanimously by roll call vote.

Next Mr. Wiseman requested a \$1,712,581 (86%) scope increase for the Center for Applied Energy Research project. This project was authorized in House Bill 1 of the 2007 Second Special Session for \$2,000,000 (General Funds). The scope increase will be used to conduct a Front End Engineering and Design Study for a Fischer-Tropshe refinery and to construct a 3,000 gross square foot shell facility that will house the

refinery. The funding sources include \$1,370,065 in federal funds from the U.S. Department of Energy and \$342,516 in state funds from the Governor's Office of Energy Policy.

Representative Denham asked if the federal funds for this project are in hand. Mr. Wiseman responded affirmatively.

Senator Carroll made a motion to approve the scope increase for the Center for Applied Energy Research project. The motion was seconded by Senator Leeper and passed by roll call vote. One member voted "No." The revised project scope is \$3,712,581.

Mr. Wiseman then reported that the university has used available restricted and federal funds totaling \$1,444,384, to acquire three items of medical research equipment. Purchases of equipment must be reported to the Committee, but no further action is required.

Representative Denham called on Jerry Graves, Deputy Commissioner of Finance, Facilities Support Services; Scott Aubrey, Assistant Director, and Charles Bush, Director, Division of Real Properties, to report a lease modification for the Energy and Environment Cabinet (PR-3882) in Franklin County. Mr. Bush said the Cabinet has requested electrical upgrades to its leased facility to accommodate power demands from specialized HVAC equipment in the agency's lab/shop area. The cost of the modifications, \$8,334, plus 6.5% interest, will be amortized over the remaining lease term (June 30, 2012). The Cabinet's monthly rental cost will increase by approximately \$227.

Representative Wayne asked if paying interest on renovations of a leased building is common practice. Mr. Bush responded that according to KRS 56.813, the costs of the improvements are normally financed and the interest is considered part of the financing cost. No Committee action is required for lease modifications under \$50,000.

Next, Representative Denham called Sandy Williams, Financial Analyst, Kentucky Infrastructure Authority (KIA), to present several new KIA loans. The first loan request was for a Fund A Loan for the City of Williamstown. Two representatives from the City joined Ms. Williams at the table - Glen Caldwell, Mayor of Williamstown; and Clay Crupper, Mayor of Dry Ridge. Ms. Williams said the City of Williamstown is again requesting approval of a Fund A loan in the amount of \$17,848,000 to construct a new two million gallons-per-day wastewater treatment plant and construct sewer lines connecting the old and new treatment plants. The term is 20 years with an interest rate of one percent.

Mayor Crupper commented that this project is a joint effort between the City of Williamstown and the City of Dry Ridge.

Representative Denham noted that both cities are in a high-growth area. Mayor Crupper responded that Grant County is one of the fastest growing counties in Kentucky.

Representative Denham asked if the rate increase had been advertised and if public hearings had been held to inform citizens. Mayor Crupper responded affirmatively.

Senator Carroll asked why the project had not been previously approved by the Committee. Representative Denham said the project had been brought to the Committee on two separate occasions. In June 2008 the project was first brought to the Committee and concerns about the rate increase resulted in a lack of a second to approve the project. In November 2008 the project was brought back to the Committee for a second time and the motion did not pass. In December, the mayors of both cities discussed the project with the Committee and have quelled some of the concerns of the Committee members.

Senator Carroll made a motion to approve the Fund A Loan for the City of Williamstown. The motion was seconded by Representative Wayne and passed unanimously by roll call vote.

Next Ms. Williams reported that three Fund A loans totaling \$22,900,578 have been awarded to the City of Owensboro for a project to begin the process of separating the storm water and sewer systems. The term is 20 years with a one percent interest rate. This loan was approved by the KIA Board at its October 2007 meeting, however, the agency overlooked submitting this loan to the Committee for approval in 2007 and has since released funds for the project. Because the funds have already been released, Committee staff recommended that no action be taken.

Representative Denham said he appreciated KIA bringing the project to the Committee's attention even though the funds were released. He also indicated that staff recommends taking no action.

In response to a question from Senator Carroll, Ms. Williams said that several different funding sources are available for this program. This particular loan is funded from repayment dollars as opposed to direct bond funds. There have been bonds issued in the past, loans were made with the bond funds, and those loans were repaid. This project is being funded by those repayment dollars.

Ms. Williams next discussed a loan request for the Lexington Fayette Urban County Government (LFUCG). LFUCG is requesting a Fund A Loan in the amount of \$17,208,000 for the purpose of upgrading the South Elkhorn pump station and constructing a force main. The term is for 20 years with a two percent interest rate.

Senator Carroll asked about the function of South Elkhorn pump station. Ms. Williams responded that it pumps the sewer from the collection system to the treatment plant.

Senator Carroll asked if the treatment plant discharges waste water into Elkhorn Creek. Ms. Williams deferred to Allen Robinson, CDP Engineers, representing LFUCG. Mr. Robinson said that it is waste water flow that is collected and pumped. The reason for the name of South Elkhorn pump station is because it is located along South Elkhorn Creek. However, it pumps about five or six miles to the West Hickman waste water treatment plant and then discharges into the West Hickman Creek, flowing into Jessamine County. He said the project would not involve any discharge into Elkhorn Creek.

In response to questions from Senator Carroll, Mr. Robinson said there is no discharge into the South Elkhorn Creek location. He said the pump station is on the South Elkhorn, but the water being moved and treated is Kentucky American Water Company's. Mr. Robinson said this project will vastly improve South Elkhorn's water quality because it will not let waste water into the creek.

Representative Denham asked what the status is of the consent decree with the Environmental Protection Agency (EPA). Mr. Robinson said that he is not familiar with the consent decree and is not involved in it. However, he said that LFUCG is proceeding with projects as if they were under the decree, but technically they have not come to an agreement.

Representative Rudy made a motion to approve the Fund A Loan for LFUCG. The motion was seconded by Representative Wayne and passed unanimously by roll call vote.

Ms. Williams then presented a Fund F loan request for the City of Paintsville. The City is requesting a loan in the amount of \$6,519,566 to construct a new four million gallon-per-day sewer plant on Paintsville Lake to replace the existing plant. The current treatment plant does not meet standards of the Safe Drinking Act. The loan term is for 20 years with a one percent interest rate.

Senator Carroll made a motion to approve the Fund F Loan for the City of Paintsville. The motion was seconded by Representative Wayne and passed unanimously by roll call vote.

Ms. Williams indicated that information on various coal and tobacco development grants approved in previous sessions of the General Assembly was included in members' folders. No Committee action was required.

Next Katie Smith, Deputy Commissioner, Cabinet for Economic Development, came forward to request approval for an Economic Development Bond (EDB) grant in the amount of \$100,000 for the benefit of Sub-Zero Wolf, Inc. in Richmond. The project entails constructing the necessary building and purchasing equipment to enable the company to manufacture a new line of luxury home appliances. Sub-Zero Wolf, Inc. would be required to create 100 new full-time jobs for Kentucky residents and pay an average hourly wage of at least \$16.36.

Senator Carroll made a motion to approve the EDB grant. The motion was seconded by Senator Leeper and passed unanimously by roll call vote.

Next Representative Denham asked Tom Howard, Executive Director, Office of Financial Management (OFM), and Brett Antle, Deputy Director, OFM, to come forward. Mr. Antle presented the first of two new bond issues for the State Property and Buildings Commission (SPBC). SPBC Revenue and Revenue Refunding Bonds, Project No. 93 will be issued in a principal amount not to exceed \$400 million. The proceeds from the bond issue will provide permanent tax-exempt financing for projects previously authorized in HB 267 (2004-06 budget), HB 380 (2006-08 budget), and HB 406 (2008-10 budget). In addition, Project No. 93 will provide financing for Economic Development Bond Pool projects authorized in HB 267 and HB 380 and refund certain bonds from the SPBC and the Asset/Liability Commission to provide budgetary relief for Fiscal Year (FY) 2010.

In response to a question from Representative Denham, Mr. Howard said the corresponding interest rate for SPBC 93 (5.99%) assumes a portion of the bonds will be issued on a taxable basis and is based on December market rates when the rates were higher. He said the Finance Cabinet is anticipating that with additional tax analysis the taxable component might be eliminated. He said this might dramatically lower the cost of funds. The transaction will include approximately \$15.7 million of capitalized interest and an \$18.8 million interest rate swap termination payment.

In response to additional questions from Representative Denham, Mr. Howard said this bond issue is a blend of tax-exempt and taxable bonds. Mr. Howard said that the state, from January 2006 to August 2007, entered into a series of interest rate swap agreements to hedge the future issuance of General Fund supported debt. He said the General Assembly has authorized a record amount of debt since 2005, totaling about \$5.5 billion, of which approximately \$4 billion was General Fund supported. Mr. Howard said by not conducting any hedges, the state was making bets that the rates would stay the same or decrease. The state entered into a series of \$600 million total in swap agreements over that time frame, and this swap is the last remaining of those transactions. He added that it was important to be able to reduce appropriations to free up money during the current budget cycle. Since that period, interest rates for the interest rate swap and cash markets have decoupled.

Representative Denham asked if the state will incur a short-term loss in order to attain long-term savings. Mr. Howard responded that the state has achieved the value of the swap and has captured that money in the appropriations process, which means the state is getting back some of that gain over the life of these bonds.

In response to questions from Senator Carroll, Mr. Howard said the maximum amount of swaps issued since January 2005 was \$600 million. He said the state was down to \$150 million of those hedges and that was all that remained. He said none of the swaps are associated with the refunding, they are only associated with the new money component. Mr. Howard said the state is looking to refund approximately \$53 million worth of bonds to achieve debt service savings, essentially moving the debt service payments coming due this summer to later maturities to create the budgetary debt service lapse that was included in HB 406.

Senator Carroll asked what the estimated annual payments on the bond issue were and what portion of that would be represented by the refunded bonds. Mr. Howard said that it was about \$3.5 million a year for 20 years. He said with this restructuring the state has shortened the term to meet the amortization goals and it appears that it will come due in FY 2017, 2018, and 2019. Mr. Howard said that he would provide the Committee with a copy of the presentation that was given to the Appropriation and Revenue Committee. Mr. Antle commented that the average annual debt service on the refunding portion is just over \$6.9 million.

In response to another question from Senator Carroll, Mr. Howard said the net total interest costs associated with the bond issue, based on current estimates for the \$50 million for FY 2010, is approximately \$23 million between now and 2019.

Senator Carroll asked Mr. Howard to discuss the state's current credit rating, as well as how the state budget shortfall will be addressed. Mr. Howard said Kentucky is currently rated Aa3 by Moody's with a negative outlook, AA- by Fitch with a negative outlook, and A+ with a positive outlook from Standard & Poor's. This week Moody's issued a report that has put a yellow flag on state credit ratings. In the past year however, there has been discussion about elevating all state ratings to reflect their relatively low-default risk. He said that OFM is preparing to send information to the rating agencies for this coming fiscal year. Mr. Howard said the sense is that Kentucky is not in as bad shape as other states.

Senator Carroll made a motion to approve the SPBC Revenue and Revenue Refunding Bonds, Project No. 93. The motion was seconded by Senator Tori and passed unanimously by roll call vote.

Mr. Antle next discussed SPBC Road Fund Revenue Bonds, Project No. 94 in an amount not to exceed \$40 million. The proceeds of the bonds will provide approximately

\$34 million of road fund bonds for the Transportation Cabinet authorized in HB 406 in the 2008 session. The financing will provide for the replacement of the Automated Vehicle Information System (AVIS) and the alignment and expansion of a runway at Bluegrass Airport.

Senator Carroll made a motion to approve the SPBC Road Fund Revenue Bonds, Project No. 94. The motion was seconded by Representative Wayne and passed unanimously by roll call vote.

Representative Rudy asked if the court ruling in Frankfort Court on the road plan had an effect on this bond issue. Mr. Howard responded that it was not affected.

Mr. Antle then presented a follow-up report for Kentucky Housing Corporation Multifamily Housing Revenue Bonds, Series 2008 (Grand Oaks Apartments Project), \$7.6 million. This bond issue was approved at a previous Committee meeting and no further action was required from the Committee.

Mr. Antle next reported two new bond issues with the School Facilities Construction Commission (SFCC) debt participation for Fayette County and Paducah Independent in McCracken County.

Senator Leeper made a motion to approve the SFCC new bond issues. The motion was seconded by Representative Wayne and passed unanimously by roll call vote.

Senator Carroll asked if any provisions in the proposed federal legislation would be helpful to the state. Mr. Howard said the proposal to eliminate the Alternative Minimum Tax for certain private activity bonds could be beneficial to the Commonwealth. Additionally, there is a proposal to raise the bank qualified amount from \$10 million to \$30 million, which could positively impact school districts.

Ms. Bowen said there was one school bond issue with 100 percent local debt service support for Mason County. All disclosure information has been filed, and no Committee action was required.

Ms. Bowen said also included in Committee members' folders were the updated debt issuance calendar and a schedule of tentative Committee meeting dates for 2009.

With there being no further business, Representative Rudy made a motion to adjourn the meeting. The motion was seconded and the meeting adjourned at 2:30 p.m.